STATE BOARD OF EQUALIZATION
STAFF LEGISLATIVE BILL ANALYSIS

Date Amended:	**03/28/00**	Bill No:	**SB 1777**
Tax:	**Sales and Use**	Author:	**Burton**
Board Position:		Related Bills:	**AB 43 (Villaraigosa)**

BILL SUMMARY:

Among its provisions, this bill would provide a 5 percent state sales and use tax exemption for sales of motor vehicle fuel (gasoline) and diesel fuel. This bill would also impose a Petroleum Windfall Profits Tax on refineries, which would be administered by the Franchise Tax Board.

ANALYSIS:

Current Law:

Existing law imposes a sales or use tax on the gross receipts from the sale of, and on the sales price of, tangible personal property, unless specifically exempted by statute. Under existing law, sales of gasoline and diesel fuel are subject to sales or use tax.

Under existing law, Section 6385 of the Revenue and Taxation Code provides a sales tax exemption for that portion of fuel and petroleum products sold to a water common carrier that is left on board after the water common carrier reaches its first out-of-state destination. With respect to air common carriers, Section 6357.5 provides an exemption for the sale or purchase of fuel and petroleum products sold to air common carriers when the fuel and petroleum products are for immediate consumption or shipment in the conduct of the air carrier's business on an international flight.

Proposed Law:

This bill would add Section 6357.7 to the Revenue and Taxation Code to provide a 5 percent state sales and use tax exemption for the sale in this state of, and the storage, use, or other consumption in this state of, motor vehicle fuel as defined in Section 7304, fuel as defined in Section 8604, diesel fuel, as defined in Section 60022, or blended diesel fuel, as defined in Section 60023.

This bill would also add Section 23481 to the Revenue and Taxation Code to impose a Windfall Profits Tax on the gross receipts from sales in California by any taxpayer that is engaged in petroleum refining. The rate of tax would be set annually by the Franchise Tax Board at a rate estimated to produce an amount of revenue with respect to gross receipts in California during the calendar year that is equal to the sum of (1) the total amount of sales and use tax revenue, as estimated by the State Board of Equalization, which would have been received if the exemption from sales and use taxes for motor vehicle fuel provided for in Section 6357.7 had not been enacted, (2) that portion, if any, of the exemption from sales and use taxes for motor vehicle fuel provided for in Section 6357.7 that is not passed on to consumers, and (3) that portion, if any, of the tax imposed pursuant to this section estimated by the State Board of Equalization to be passed on by taxpayers to consumers in the form of increased pump prices for motor vehicle fuel. Revenue derived from the tax imposed pursuant to this section would be deposited in the Petroleum Windfall Profits Fund, which this bill would create.

This bill would also add Section 7102.5 to the Revenue and Taxation Code to provide that the Controller transfer from the Petroleum Windfall Profits Fund, created in Section 23481, to the Public Transportation Account in the State Transportation Fund, an amount equal to the revenue that would have been received by the Public Transportation Account pursuant to subdivision (a) of Section 7102 if motor vehicle fuel had not been exempt from sales and use taxes. This bill would also provide that the Controller transfer the balance of the Petroleum Windfall Profits Fund, after the transfer above, to the General Fund.

The provisions of the bill would go into immediate effect, and would become operative on the 15th day after the effective date of this act.

Background:

Senate Bill 325 (Ch. 1400, 1971) made possible the imposition of state sales and use tax on sales of gasoline, and in exchange for a reduction in the basic state tax rate, from 4 percent to 3 ¾ percent, without a corresponding loss in revenue. In addition to taxing sales of gasoline, SB 325 also provided that the federal and state imposed excise taxes on gasoline are subject to the sales and use tax. That bill also required that that any sales tax collected above the amount that would have been collected if the tax rate had remained at 4 percent and gasoline remained exempt from the sales tax, be transferred to the Transportation Planning and Development Account.

COMMENTS:

1. Sponsor and Purpose. According to Senator Burton's office, who is also the sponsor of the bill, this measure is intended to help lower gasoline and diesel prices by reducing the sales tax on gasoline and diesel fuel sales and imposing a windfall profits tax on refineries who fail to pass on the tax savings to the consumer.

2. Partial tax exemptions are difficult to administer. Due to the method used to report partial tax exemptions, any return containing a claimed partial tax exemption must be processed manually for the proper allocation of local taxes. Current law provides for two partial tax exemptions. The current partial tax exemptions apply to sales of manufacturing equipment and teleproduction equipment. The number of returns affected by the current partial tax exemptions are minor. However, the provisions of this bill would cause a significant increase in the number of returns filed containing a partial tax exemption.

3. Proposed exemption would become operative 15 days after the effective date. A new sales and use tax exemption would require the Board of Equalization to notify affected retailers of the law change. This is typically accomplished by publishing an article in our quarterly Tax Information Bulletin mailed to taxpayers and/or mailing a special notice to affected taxpayers. Additionally, once taxpayers are notified of the change, they would be required to reprogram their registers and pumps so that tax

would not be collected on exempt sales. For these reasons, the operative date of 15 days after the effective date of the proposed statute would place a burden on retailers and the Board of Equalization.

4. Law change could occur in the middle of a reporting period. To simplify reporting for seller's and administration of the exemption for the Board of Equalization, the operative date of changes in tax law should generally coincide with a new reporting period, such as the first day of the year or the first day of the quarter. The provisions of this bill provide for an operative date 15 days after the effective date. Therefore, the operative date could fall on any day of the month. This could potentially cause retailers to report sales of gasoline as both taxable and partially exempt during the same reporting period, which could lead to a significant number of reporting errors. While it is understood that the current high prices of gasoline necessitate that the provisions of this bill take effect as soon as possible, it is recommended that the bill be amended to allow the bill to become operative on the first day of the month commencing more than 15 days after the bill is enacted.

5. Board would be required to adjust the prepaid sales tax rate for gasoline. Current law requires any distributor of motor vehicle fuel (gasoline) to collect prepayment of retail sales tax from the person to whom the motor vehicle fuel is distributed. The current prepayment rate is 8 ½ cents per gallon. The prepayment rate is based on 80 percent of the total tax rate on the average selling price of gasoline. The partial tax exemption for sales of gasoline created by this bill would result in gasoline retailer's making prepayments to their distributors that are greater than their total tax liabilities. The Board would be required to process numerous claims for refund due to the overpayments, or readjust the prepayment rate collected by distributors during the period in which sales of gasoline are exempt from tax. Board staff is willing to work with the author's office to draft appropriate language to amend Section 6480.1 that would allow the Board to adjust the prepayment rate.

6. Petroleum Windfall Profits Tax. Reducing the amount of sales and use taxes imposed on sales of gasoline, motor vehicle fuel, diesel and blended diesel (hereafter referred to as "fuel") are intended to result in a decrease in the sales price charged to consumers. However, economic laws of supply and demand could result in retailers absorbing the tax savings as profits which would be of no benefit to consumers. To help prevent this from happening, this bill would establish a Petroleum Windfall Profits Tax that would be imposed upon refiners of fuel and administered by the Franchise Tax Board (FTB). The FTB would be required to annually set an income tax rate that would produce an amount of revenue equal to the sum of the following:

- The total amount of sales and use tax revenue, as estimated by the Board, which would have been received if there was no exemption.
- That portion, if any, of the exemption from sales and use taxes for fuel that is not passed on to customers.
- That portion, if any, of the tax imposed pursuant to this section estimated by the Board to be passed on by taxpayers to consumers in the form of increased pump prices for fuel.

The Board should not have any administrative problems determining the amount of sales and use tax revenue that would have been received if there were no exemption. However, due to supply and demand market conditions, it may be difficult for the Board to ascertain the amount, if any, of the exemption from sales and use taxes for fuel that is not passed on to customers or the portion, if any, of the tax imposed pursuant to this section that is passed on by taxpayers to consumers in the form of increased pump prices for fuel.

7. <u>Interstate users would continue to pay an amount equivalent to the sales tax.</u> Pursuant to Sections 60115 and 60116 of the Diesel Fuel Tax Law, interstate users must pay an excise tax on each gallon of diesel fuel used in this state at a tax rate of 18 cents per gallon plus an amount equivalent to the rate of sales tax imposed on diesel fuel purchased in this state. Interstate users can subsequently claim a credit for the total amount of the tax on each gallon used outside California provided they actually paid the tax to an in-state retailer. These provisions in the law were added by AB 1269 (Ch. 618, 1997) in order to eliminate the incentive for an interstate user to tank up outside California. Without conforming amendments to Sections 60115 and 60116, interstate users would still be required to pay the equivalent sales tax component on their use of diesel fuel in this state, provided this bill were enacted.

8. <u>Related Legislation.</u> Assembly Bill 43 (Villaraigosa), as amended on March 22, 2000, would exempt gasoline and diesel fuel from the sales tax from June 1, 2000 through September 30, 2000.

COST ESTIMATE:

Some costs would be incurred in notifying affected retailers and responding to inquiries. Additionally, because of the partial exemption, administrative costs would be incurred in computer programming, return revisions, return analysis and return processing. Additional resources would be required for the Local Revenue and Allocation Section for manual processing of the returns containing the partial exemption. A detailed estimate of these costs is pending

REVENUE ESTIMATE:

Motor vehicle fuel

According to the California Energy Commission, the average retail price of gasoline for the month of February 2000 was $1.540 per gallon. This price includes the sales tax. The average price minus the sales tax is $1.427 per gallon ($1.540 per gallon / 1.0792 = $1.427.)

Consumption of motor vehicle fuel (gasoline) in California is estimated to be 14.5 billion gallons annually.

Total annual sales of gasoline are estimated to be $20.7 billion. (14.5 billion gallons x $1.427 per gallon = $20.7 billion.)

Diesel fuel

According to the California Energy Commission, the average retail price of diesel fuel as of March 15, 2000 was $1.709 per gallon. This price includes the sales tax. The average price minus the sales tax is then $1.709 per gallon / 1.0792 or $1.584 per gallon.

Consumption of diesel fuel in California is estimated to be 2.4 billion gallons annually. The total estimated annual sales of diesel fuel are estimated to be $3.8 billion (2.4 billion gallons x $1.584).

Use Fuel

Fuel subject to the use fuel tax consists of LPG, alcohol fuel, CNG and kerosene. Consumption of these fuels is minor compared to the consumption of gasoline and diesel fuel. Annual sales of these fuels are estimated to amount to about $50 million.

Revenue Summary

The revenue impact from exempting gasoline, diesel and use fuel from the 5% state sales and use tax would be as follows:

	Annual Sales	Revenue Effect
Gasoline	$20,700 million	$1,035 million
Diesel Fuel	3,800 million	190 million
Use Fuel	50 million	3 million
Total	$24,550 million	$1,228 million

This bill would also create the Petroleum Windfall Profits Tax, an income tax which would be administered by the Franchise Tax Board. The Petroleum Windfall Profits Tax should result in an increase in revenue substantially similar to the revenue loss incurred due to the sales and use tax exemption. Additionally, the Windfall Profits Tax could result in tax revenues that exceed the revenue loss incurred due to the sales and use exemption. The extent that the tax increase would exceed the tax exemption would be entirely dependent on whether the refineries attempt to pass the tax expense on to consumer in the form of higher prices.

Analysis prepared by:	Bradley E. Miller	445-6662	4/20/00
Revenue estimate by:	David E. Hayes	445-0840	
Contact:	Margaret S. Shedd	322-2376	

This staff analysis is provided to address various administrative, cost, revenue and policy issues; it is not to be construed to reflect or suggest the Board's formal position.